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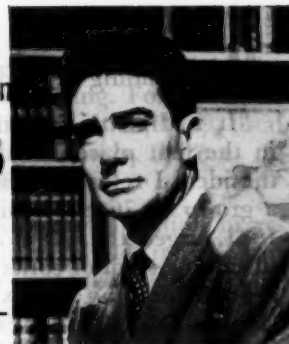
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DAN SMOOT

WITHHOLDING TAX

On September 23, 1959, Mr. Raymond E. Manning, Senior Specialist in Taxation, Legislative Reference Service, The Library of Congress, wrote to a United States Congressman, saying:

"This memorandum is in response to your letter of September 14 (1959) addressed to the Librarian. You asked six separate questions relating to the withholding tax. These are answered below"

The Congressman had asked:

What law of Congress authorized the federal withholding tax, and when?

Mr. Manning replied:

"Withholding of individual income tax in its present form on wages and salaries was instituted under the Current Tax Payment Act of 1943 (Act of June 9, 1943, 57 Stat. 126).

"It must be noted quickly, however, that while this legislation is the foundation of our present law, withholding was not altogether new with this act. Eight months earlier, the Revenue Act of 1942 had included the flat rate 5 percent Victory tax levied on gross income, less certain credits (Act of October 21, 1942, Sec. 172, 56 Stat. 798, effective January 1, 1943); it too provided for withholding (upon enactment of the current Tax Payment Act of 1943, withholding of the Victory Tax was absorbed in the new withholding system).

"Still earlier, the Social Security Act of 1935 (Act of August 14, 1935, 49 Stat. 620) had provided that employers should collect the social security tax from their employees and pay it over to the Treasury. But not even these acts mark the first beginning, because withholding in a limited way was a feature of the Civil War income tax acts (see Edwin R. A. Seligman, 'The Income Tax,' 1914, p. 430-482), as well as the first income tax (1913-1916) after adoption of the Sixteenth Amendment (Act of October 3, 1913, 38 Stat. 114)."

The Congressman had asked:

Whose idea was the withholding tax, in the first place?

THE DAN SMOOT REPORT, a magazine edited and published weekly by Dan Smoot, mailing address P.O. Box 9611, Lakewood Station, Dallas 14, Texas, Telephone TAylor 4-8683 (Office Address 6441 Gaston Avenue). Subscription rates: \$10.00 a year, \$6.00 for 6 months, \$3.00 for 3 months, \$18.00 for two years. For first class mail \$12.00 a year; by airmail (including APO and FPO) \$14.00 a year. Reprints of specific issues: 1 copy for 25¢; 6 for \$1.00; 50 for \$5.50; 100 for \$10.00—each price for bulk mailing to one person.

Mr. Manning replied:

"It is difficult to pinpoint 'whose idea it was in the first place,' in the sense of who first had the idea. I refer, however, to a memorandum by a group of 76 economists who, in the spring of 1941, urged the Ways and Means Committee to install a system of collection at the source, including withholding of taxes on wages and salaries (House Ways and Means Committee Hearings, 'Revenue Revision of 1941,' p. 333-334, 365-366).

"In November, 1941, after the whole problem of current payment had been under consideration in the Treasury for a long time, Secretary of the Treasury Morgenthau informally presented to the Ways and Means Committee a plan for collecting at the source, but the committee turned a deaf ear (see Randolph E. Paul, 'Taxation for Prosperity,' 1947, p. 117).

"Mr. Morgenthau in early 1942 made additional representations on behalf of a collection-at-source system (House Ways and Means Committee Hearings, 'Revenue Revision of 1942,' p. 5, 20, 81, 82).

"Beardsley Ruml achieved considerable publicity in connection with his 'Pay-as-you-go income-tax plan,' but his proposal (at least in the beginning) did not include withholding (Senate Finance Committee Hearings, 'Revenue Act of 1942,' p. 186)."

The Congressman had asked:

What were the principal arguments in favor of a withholding tax?

Mr. Manning replied:

"The arguments offered in support of withholding varied somewhat as between the various proponents. A composite of the arguments follows:

"1. Under the preexisting method, the income tax was entirely collected in the year following that in which it was earned. The taxpayer was thus always 1 year in debt on his tax; and if he suffered a reduction in income, whether through loss of job, death, or other reason, the tax debt of the prior year might become a substantial financial burden.

"2. Under the preexisting system, payment of

the tax even in quarterly instalments presented problems to many taxpayers accustomed to weekly or monthly budgeting. Withholding would put most taxpayers on a current basis.

"3. Withholding would insure collection of taxes from persons who underreported their income, did not report at all, or otherwise defaulted in payments due.

"4. Withholding would enable the immediate utilization of higher tax rates to help finance current wartime expenditures. Without withholding, it would be necessary to wait many months before realizing the revenue benefits of any tax rate rise.

"5. Withholding at higher rates as applied against current earnings during a period of rapid price rises and increased demand simultaneously with a decreasing supply of consumer goods, would permit the utilization of the income tax as an important instrument for curbing inflation.

"6. Revenue would be collected without the taxpayer really noting its loss. He wouldn't miss what he never had. (At the same time, directly the opposite argument was made that this periodic deduction from pay envelopes would promote a desirable tax consciousness on the part of the people)."

The Congressman had asked:

Has there been much resistance to the withholding tax, on the part of business firms who do the bookkeeping and tax-collecting for the government?

Mr. Manning replied:

"If we use the word 'resistance' in the sense of refusing to cooperate, there has been relatively little of this. The case that attracted most attention was that of the Connecticut woman-industrialist, Vivien Kellems, who declined to cooperate (Kellem v. U.S., 97 F. Supp. 681 - 1951. See also Abney v. Campbell, 105 F. Supp. 740 - 1951 - 206 F. 2d. 836 - 1953 - certiorari denied, U.S. Supreme Court, January 4, 1954. See also Miss Kellem's book, 'Toil, Taxes, and Trouble.')

"This does not mean that 'cooperation' has been gladly given. There has been much reluctance, especially on the part of small business, to perform the role of tax collector for the United States. For the most part, there has been accept-

ance of the obligation as one that must be lived with.

"Evidence of this is the almost complete absence of any effort on the part of Members of Congress to seek repeal of the law.

"Of perhaps only limited interest is a recent article alleging that the whole process involves involuntary servitude of a nature forbidden by the Constitution (see George Rose, 'Involuntary Servitude and the State,' *Taxes — The Tax Magazine*, March, 1959, p. 209-224)."

The Congressman had asked:

What state governments have adopted a withholding tax?

Mr. Manning replied:

"The following state governments have adopted laws of general application for withholding of income tax from wages and salaries (numerous municipal income taxes provide for withholding): Alabama, Alaska, Arizona, Colorado, Delaware, District of Columbia, Idaho, Indiana, Kentucky, Maryland, Massachusetts, Montana, New York, North Carolina, Oklahoma, Oregon, South Carolina, Utah, Vermont.

"The following states which impose an income tax on salaries and wages either have no provision for withholding, or limit its application to nonresidents or certain other special situations: Arkansas, California, Georgia, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, New Mexico, North Dakota, Tennessee, Virginia, Wisconsin.

"A unique feature of the Massachusetts withholding tax, which was adopted in 1959, provided for compensation to employers who withhold from their employees. This prompted legislation by the recently adjourned Congress to forbid any Federal agency from accepting compensation for taxes withheld by it as an employer in Massachusetts (or any other State)."

The United States Congressman had asked for other "pertinent facts" about the withholding tax. Mr. Raymond E. Manning, Senior Specialist in Taxation, Legislative Reference Service, The Library of Congress, replied:

"More than two-thirds of total net Federal

individual income tax revenues (after refunds) are collected through withholding. For example, during the fiscal year ending June 30, 1959, total individual income tax collections (before refunds) amounted to \$40.7 billion.

"Allowing for an estimated \$4.3 billion of refunds attributable to taxes withheld, the proportions may then be set out roughly as follows (the figures are only approximate because published data do not permit an exact breakdown):

"Income tax withheld.....\$24.7 billions; 67.9%

"Income tax not withheld \$11.7 billions; 32.1%

"Total.....\$36.4 billions; 100.0%

THE ANCIENT STRUGGLE

The foregoing memorandum gives a good, skeleton outline of the story of the withholding tax in America. To cover these bare bones with the flesh and blood of history, we must do more than review the statutes of Congress.

The essential political struggle of our time is the conflict between individual men and all-powerful-government, between individualism and collectivism. This has been the central political struggle of mankind since the beginning of recorded history.

All collectivists — however well-intentioned they may be, or whatever they may be called — believe that government must be all-powerful: It must have absolute authority to manage all the affairs of all the people, because people cannot, or will not, manage their own affairs.

BEFORE 1913

At the beginning of America's national life, collectivists were, as always, powerful; but individualists were in control. The Declaration of Independence, firmly relying on the protection of Divine Providence, asserted, as self-evident truth, the great ideal of individualists: that all men are endowed by their creator with unalienable rights; and that governments are instituted, not to give

men any rights, but merely to secure the rights which God has already given them.

Individualists were still in control 13 years later, in 1789, when the Constitution was written; but the conflict between individual men and all-powerful-government — between individualism and collectivism—did not end with adoption of the Constitution.

In the first Congress of the United States this ancient political struggle was identified as a conflict between those who believed in strict construction (or interpretation) of the Constitution and those who believed in loose construction.

Individualists who wrote the Constitution claimed that it means strictly what it says, and should be strictly construed that way. It grants specific powers to the federal government and emphatically says that the government shall have no other powers.

Collectivists who believed in "loose construction" of the Constitution were American patriots in the sense that they wanted American independence from foreign governments; but they did not believe in the great ideal imbedded in the Declaration of Independence. They could not imagine an organized society in which people would be practically independent of *their own government*. Their thinking was deeply dyed with the concept of government prevalent throughout the world and throughout history prior to 1776: namely, that rights and powers reside in government, and that a "good" government is one which gives the people a maximum of rights and powers.

The Jeffersonian-Madisonian (the individualist) concept that all rights and power reside in people and that it is people who give rights and power to government, rather than the other way around—this concept seemed absurd to those who wanted a loose construction of the Constitution. They did not think that government could function if the Constitution were strictly interpreted to mean that government had only those powers specifically stated. They wanted a "flexi-

ble" Constitution — wanted it loosely interpreted to mean that America would be governed by officials whom the people selected, but that the specific means of governing would be determined, in accordance with the "needs of the times," by the governing officials, within the general framework of what seemed, loosely, to be the general purpose of the Constitution.

From 1789 to 1913, Americans who believed that the Constitution is an honest document, meaning what it says and no more, had the advantage over those who felt that the Constitution could be interpreted to mean all things to all men. The "strict-constructionists" (as the Jeffersonian-Madisonians are generally called) lost many important skirmishes to the "loose-constructionists," but there was never any possibility that they would lose the war — until 1913.

Before 1913, American political forces of the "loose-constructionist" persuasion could win the presidency and both houses of Congress (and the judiciary too, for that matter), but there wasn't much they could do about making the federal government all-powerful (except during the Civil War when the Constitution was buried under the emergency). When you talk about government, *power is synonymous with wealth of the people*. If government cannot get the wealth of the people, government has no power.

Before 1913, our old Constitution limited the federal government's means of confiscating, through taxes, the wealth of the people. Hence the Jeffersonian-Madisonian ideal of a government limited in power was so firmly lodged in the Constitution that the loose-constructionists could not get it out without major surgery.

In 1913, that major surgery was performed: the Sixteenth, or Income Tax, Amendment was adopted, giving the federal government uncontrolled access to the wealth of the people.

SINCE 1913

From 1789 to 1913, the political struggle in

America between "strict constructionists" and "loose constructionists" (that is, between individualism and collectivism) seldom threatened disaster to the cause of freedom. Advocates of all-powerful-government could get control of the federal establishment, but they still could not inaugurate programs which would destroy freedom, because they could not get their hands on enough of the people's money to pay for their schemes.

Since 1913, the character of the political struggle in the United States has changed mightily. Now, advocates of all-powerful-government can get as much of the people's wealth as they want, if they can just get control of the governmental establishment. It was 20 years after the Income Tax Amendment was adopted before it occurred to these forces that they had, ready-made, an almost flawless means of capturing and keeping the governmental establishment: just appeal to the natural greed of people — promise them anything they want and then impose enough taxes on them to keep the promise.

Roosevelt made this discovery. Since his first administration, the practice of buying votes with the voters' own money has become the fixed habit of both major political parties. Indeed, it has become national policy.

Roosevelt made another discovery: if you impose too much tax on people to pay for the "benefits" you have promised them, they will begin to complain about the tax and forget the benefits. Roosevelt found a way out: deficit financing. Buy votes by promising the people something they want, but don't alienate their votes by taxing them too heavily to pay for what you give them: just spend money that you don't have, borrowing against the future, so that you can buy a man's vote with his grandson's money. Then, all the governmental benefits you give him will really seem like something for nothing.

But this system also catches up with itself. Deficit financing causes inflation. That may feel all right at first; but, presently, old people living on fixed amounts which they made provision for in their youth; people on pensions; people on the

same salaries they used to have — all begin to suffer, because their dollars won't buy enough.

The vote-buyers begin to lose some of the votes they have bought. They can pass minimum-wage laws forcing some employers to pay wages above the free-market level. They can give international unions the sanction of law to force industry-wide wage rises. They can give government pensions to some who don't have them, and raise the amount of pensions for others. All such measures give temporary relief to voters who have been hurt by inflation; but the relief vanishes and conditions get worse when prices rise (as they must) to keep pace with the wage-spiral which government is forcing upward.

THE PERSONABLE PARASITE

Ultimately, the senseless squandering of public funds requires higher taxes on the people. How can you prevent rebellion against taxes when they reach such heights that many workers have to pay out more for federal taxes than for either of the three essentials of life — food, clothing, or housing?

Roosevelt found an answer to this baffling question too: Beardsley Ruml and Henry Morgenthau told him about the withholding tax: force a man's employer to collect the tax before the employee gets his salary check. This does a number of things.

It places the stigma and the expense of tax-collecting on employers rather than on government; and it eliminates popular complaint against high and rising taxes, because workers do not fully realize that taxes are high and rising.

A man doesn't have to save and manage so that, at the end of the year, he can give government 25% or 40% or 50% of his earnings for the whole year. All of that has been done by the employer, at the employer's expense. The average worker pays little attention to the federal income and social security taxes taken out of his paycheck. He quickly adjusts himself to the net amount he

gets each payday. If that is not enough, he and his family resent the employer, not government. They do not demand lower taxes: they demand higher wages.

Withholding tax can, indeed, make taxes pleasant. Internal Revenue Service schedules require employers to deduct (more often than not) more taxes than the employee owes. At the end of the year, government sends the employee a rebate — a bonus, bigger, in millions of cases, than any bonus the employer ever gives. Thus, beneficent government gives back to workers a portion of the money which employers took away from them!

Of the 61 million (approximate) federal income tax returns filed for the year 1958, about 36 million claimed a refund from the government for over-payment!

All of the 36 million taxpayers who got a refund from government were not happy about it. Many individual taxpayers in the lower brackets are hurt severely by government's practice of taking more than it has coming, and then giving a refund some time after the end of the year. The case of Mr. and Mrs. Howard J. Lobb, Jr., of Kansas City, Missouri, is illustrative. Mrs. Lobb explains their case in these words:

"During 1958, we were required through the withholding system to pay the U. S. government \$347.22 more in taxes than we owed; and it was not returned to us until April, 1959.

"In 1958, because of medical expense and a few other difficulties, we had to borrow money (at interest, of course) while Uncle Sam was taking out of our wages about \$30.00 a month more than he had coming. In January, 1959, in addition to borrowing, we had to sell 25 shares of a private mutual stock fund at \$10.00 per share, in order to survive. This cannot be repurchased at option, and, even so, by the end of May, 1959, these same shares would have been worth \$11.12. This is the only retirement plan we have outside of social security.

"Uncle Sam paid us no interest on the money he 'borrowed' from us. In fact, the \$347.22 which he paid us back in April, 1959, was not worth as much as the \$347.22 which he took away from us

during 1958, because of rising prices. The dollars wouldn't buy as much.

"There are others in a more desperate situation than we are. They are people who are out of a job for some months during the year; but when they return to work under the withholding system, their wages are subject to the same tax as those who have been working all year.

"This is people for the government; not government for the people.

"We have four children, and \$30.00 a month means a lot to us, but I don't think it means anything to congressmen and senators. They are all 'friends of the little people,' but they are too far removed from people like us to know that it really hurts to take \$10 or \$20 or \$30 a month away from us. They're too busy worrying about how to collect it so they can toss it into a foreign aid program to help people who don't need it as much as we do."

Many harsh inequities result from the withholding tax system. It would not do — politically — to make wage-earners pay taxes as they go, while permitting self-employed persons to wait until the following year to pay their taxes; but there is no way to withhold a tax from someone who does not get wages. Solution? Make self-employed persons *anticipate* their income for the year, and pay their tax in *advance*. That's what people who are not on salaries have to do. If business is better than they guessed it would be — that is, if the *estimated* tax which they pay in advance for a given year, turns out to be less than they finally have to pay for that year — they are fined for having guessed wrong. If their estimate is wrong in the other direction — that is, if they over-pay their tax in advance — they merely get it back without interest, three or four months after the end of the year.

Every year, thousands of small businessmen have to dig into working capital (thus making growth of their business impossible, often making it difficult for the business even to hold its own) or borrow at interest to pay federal taxes on income that has not even been made yet. Federal taxes force many small businessmen into bankruptcy in years when they suffer a slump in busi-

ness — because they must pay, during a year of business losses, federal taxes estimated on the basis of a previous year when there were profits.

The number of taxpayers who are thus painfully conscious each year of the harshness and weight of federal taxes is, however, relatively small. Of the 36 million who received refunds on their taxes in 1958, only a small percentage were, like the Lobb family in Kansas, keenly aware of what had been done to them.

Having taken the pain out of federal taxation for most taxpayers, the withholding tax is popular. It is especially popular with all governments which use it.

There are 19 state governments which use the withholding tax, and the number grows each year.

On May 11, 1959, Charles Stafford, staff writer for the Associated Press, said:

"That parasite of the paycheck, the tax withholding plan, is spreading to new fields this year as state legislators wrestle with the money problems

"Since the year began, four states have started withholding income taxes from the paychecks of their taxpaying citizens. Five more are considering pay-as-you-earn taxation, and at least two of these seem likely to approve it.

"For despite its nibbling ways, withholding is a personable parasite that quickly wins over tax collector and taxpayer alike.

"Officials of the 11 states which have been withholding long enough to evaluate its worth say it has this double blessing:

"1. The state collects more income, more efficiently, from its income tax.

"2. The taxpayer, who often gets a refund each spring, takes a kinder view of income taxation."

WHAT TO DO ABOUT IT

Some employers, who bear the responsibility and expense of collecting the withholding tax and

who know that the growing tax load will ultimately crush all vigor and freedom out of our economic system, have tried various ways of making their employees aware of the taxes withheld from their wages.

For example, in 1957, Mr. Walter Knott, founder and owner of the famous Knott's Berry Farm, Buena Park, California, began the practice of enclosing a letter with the W2 Form which he must send each employee at the end of the year. Here are excerpts from Mr. Knott's letter:

"... Your W2 Form . . . tells you the amount we have been required to hold out of *your* earnings for income tax during 1957. This entails considerable cost. We did not ask for this job nor are we paid for it, nor are we even thanked for it. . . .

"The amendment to the Constitution which made this tax possible was passed in 1913. This law was conceived in immorality because it was the plan to soak only the rich, and there were only a few of them, and they had few votes. Then, the top bracket was only 6%, but now the top bracket takes 91% of that same rich man's income.

"But here is the joker — when you give the politician the immoral privilege of taxing the rich man's income, soon he is not satisfied with this and is taxing *yours* too. While this started out with taxing the rich 6%, now the lowest income people are paying 20%.

"And more than 80% of the total of this so-called 'rich man's tax' is paid by the people whose income is under \$6000 per year. So while the first intention was to soak someone else, we are *all* paying the penalty now.

"Let's go to work and repeal this thing. Do I hear someone say, 'Where would the government get the money to run on without the Income Tax?' Last year the government took in, in round numbers \$72 billion; \$33 billion of this came from personal income tax. This left \$39 billion from other sources, which is just the amount that President Truman *spent in the most expensive peacetime year of his administration*. If we could do with that much then, we could now

"Every time the government takes more of our income and does more things, for more people,

all over the world, it gets bigger and more autocratic — and we, the people, get more regulated, regimented, and less able to do for ourselves. I can prove this. The very fact that the government makes *us* take this money out of *your* wages proves that they do not trust you to manage your own affairs any more; otherwise, they would let you handle your own money and pay it at the end of the year.

"We would be infinitely better off with less government, and the only way we will ever have less government is to take away the money they do not need and are wasting.

"This is *your* money I am talking about. Look at this enclosed slip and think what you could have done with this money if we we could have left it in your check. . . ."

Other employers have tried other methods; and they all do some good; but nothing would have the quick and startling effect that repealing the withholding tax would have.

A man with two deductions who makes \$5000.00 a year can adjust himself to the \$12.80 withheld for federal income tax each week. But let him take that money home each week and put it to the uses which his wife will help him find for it; and then, at the end of the year, let him and his wife face the problem of raising \$665.60 to pay their federal income tax.

This would undeniably create chaos for the tax collectors. It would cut down on the government's tax revenue; and it would produce millions of tax delinquents; but it would set the American people on the road to recapturing control of their own government. If, at the end of 1960, every taxpayer in America had to face the problem of paying the federal government the total income tax imposed on him that year, we would find a substantial crop of politicians in the next election year campaigning on a platform to repeal the income tax amendment.

We cannot restore our constitutional republic until we force the federal government to live by the Constitution. We cannot force it to do that until we take the excess money away from the Washington spenders. We cannot do that until we repeal the income tax amendment; and we cannot repeal the income tax amendment until millions of Americans become so painfully aware of federal taxation that they demand repeal of the whole immoral system.

The best way to start is to demand that Congress repeal the withholding tax. This could be done at any time, by a simple majority vote in House and Senate.

* * * * *

WHO IS DAN SMOOT?

Dan Smoot was born in Missouri. Reared in Texas, he attended SMU in Dallas, taking BA and MA degrees from that university in 1938 and 1940.

In 1941, he joined the faculty at Harvard as a Teaching Fellow in English, doing graduate work for the degree of Doctor of Philosophy in the field of American Civilization.

In 1942, he took leave of absence from Harvard in order to join the FBI. At the close of the war, he stayed in the FBI, rather than return to Harvard.

He served as an FBI Agent in all parts of the nation, handling all kinds of assignments. But for three and a half years, he worked exclusively on communist investigations in the industrial midwest. For two years following that, he was on FBI headquarters staff in Washington, as an Administrative Assistant to J. Edgar Hoover.

After nine and a half years in the FBI, Smoot resigned to help start the Facts Forum movement in Dallas. As the radio and television commentator for Facts Forum, Smoot, for almost four years spoke to a national audience giving both sides of great controversial issues.

In July, 1955, he resigned and started his own independent program, in order to give only one side — the side that uses fundamental American principles as a yardstick for measuring all important issues.

If you believe that Dan Smoot is providing effective tools for those who want to think and talk and write on the side of freedom, you can help immensely by subscribing, and encouraging others to subscribe, to *The Dan Smoot Report*.